

**GOVERNMENT OF THE DISTRICT OF COLUMBIA
OFFICE OF THE INSPECTOR GENERAL**

DISTRICT OF COLUMBIA

Management letter

September 30, 2001



**CHARLES C. MADDOX, ESQ.
INSPECTOR GENERAL**

GOVERNMENT OF THE DISTRICT OF COLUMBIA
Office of the Inspector General



Inspector General

April 11, 2002

The Honorable Anthony A. Williams
Mayor
District of Columbia
John A. Wilson Building, Suite 600
1350 Pennsylvania Avenue, N.W.
Washington, D.C. 20004

The Honorable Linda W. Cropp
Chairman
Council of the District of Columbia
John A. Wilson Building, Suite 504
1350 Pennsylvania Avenue, N.W.
Washington, D.C. 20004

Dear Mayor Williams and Chairman Cropp:

In connection with the audit of the District of Columbia's general purpose financial statements for fiscal year (FY) 2001, KPMG LLP submitted the enclosed final Management Letter. The Management Letter details the conditions that city government officials should improve in order to enhance the District's financial management infrastructure. The report also indicates the extent to which the District corrected the conditions cited in the Management Letter for FY 2000.

The Office of the Inspector General's (OIG) analyses of the Management Letters for FYs 2001 and 2000 show that the District continues to make progress but challenges remain. The Management Letter's principal comments relate to material weaknesses and other reportable conditions affecting the District's financial management infrastructure. Material weaknesses in internal control discussed in the Management letter and other reports indicate areas where the District's financial statements are vulnerable to material misstatements that may occur and not be detected within a timely period by District employees in the normal course of performing their assigned duties.

Material weaknesses declined from five in FY 2000 to three in FY 2001. The five material weaknesses for FY 2000 involved the following:

- (1) University of the District of Columbia accounting;
- (2) cash management;
- (3) accounting for payroll transactions;
- (4) disability compensation claims management; and
- (5) Public Benefit Corporation accounting.

Material weaknesses for FY 2001 centered on the following:

- (1) University of the District of Columbia;
- (2) accounting and financial reporting by the District of Columbia Public Schools; and
- (3) the District's Medicaid program.

Other reportable conditions relate to significant deficiencies in the design or operation of internal control over financial reporting that could adversely affect the District's ability to record, process, summarize, and report financial data consistent with the assertions of management. For FY 2001, there were six such reportable conditions. These conditions related to areas such as cash management, payroll process management, accounting for non-routine transactions, and budgetary revisions. Though not as serious as material weaknesses, other reportable conditions also warrant priority attention.

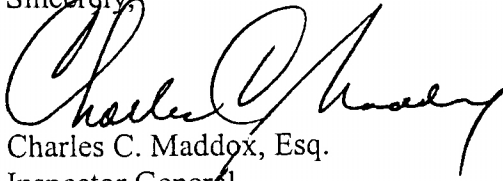
The FY 2001 Management Letter also comments on the implementation of a new accounting standard for FY 2002. KPMG stated that implementation of Governmental Accounting Standards Board (GASB) Statement No. 34 (Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments) presents a significant challenge for the District (as well as state and local jurisdictions nationwide). GASB 34 is a sweeping revision of the current financial reporting model that has been in place for local and state governments since 1979. GASB 34 redefines how the financial statements of local and state governments are required to be presented in order for the statements to be in compliance with generally accepted accounting principles. KPMG recommends that the District create a GASB 34 Steering Committee to assist in monitoring progress towards successful implementation of GASB 34.

KPMG set forth recommendations for correcting material weaknesses and other reportable conditions noted. While the OIG will continue to assess the District agencies' implementation of recommendations, it is the responsibility of District government management to ensure that agencies correct the deficiencies noted in audit reports. The OIG will work with managers, as appropriate, to help them monitor the implementation of recommendations.

April 11, 2002

If you have questions or need additional information, please contact William J. DiVello,
Assistant Inspector General for Audits, at (202) 727-2540.

Sincerely,

A handwritten signature in black ink, appearing to read "Charles C. Maddox". The signature is fluid and cursive, with the first name "Charles" being more prominent.

Charles C. Maddox, Esq.
Inspector General

Enclosure

CCM/ws

cc: See Distribution List

April 11, 2002

DISTRIBUTION:

The Honorable Anthony A. Williams, Mayor, District of Columbia (1 copy)
Mr. Kelvin J. Robinson, Chief of Staff, Office of the Mayor (1 copy)
Mr. John A. Koskinen, Deputy Mayor and City Administrator (1 copy)
Mr. Tony Bullock, Director, Office of Communications (1 copy)
The Honorable Linda W. Cropp, Chairman, Council of the District of Columbia (1 copy)
Ms. Phyllis Jones, Secretary to the Council (13 copies)
The Honorable Vincent B. Orange, Sr., Chairperson, Committee on Government Operations, Council of the District of Columbia (1 copy)
Dr. Natwar M. Gandhi, Chief Financial Officer (4 copies)
Ms. Deborah K. Nichols, D.C. Auditor (1 copy)
Mr. Jeffrey C. Steinhoff, Managing Director, GAO (1 copy)
Ms. Jeanette M. Franzel, Acting Director, IRS Financial Management, GAO (1 copy)
The Honorable Eleanor Holmes Norton, D.C. Delegate, House of Representatives (1 copy)
Mr. Jon Bouker, Office of the Honorable Eleanor Holmes Norton (1 copy)
The Honorable Joe Knollenberg, Chairman, House Subcommittee on D.C. Appropriations (1 copy)
Mr. Jeff Onizuk, Legislative Director, House Subcommittee on D.C. Appropriations (1 copy)
Ms. Carol Murphy, Staff Assistant, House Subcommittee on D.C. Appropriations (1 copy)
The Honorable Chaka Fattah, House Committee on D. C. Appropriations (1 copy)
Mr. Tom Forhan, Minority Staff Director, Office of the Honorable Chaka Fattah (1 copy)
The Honorable Connie Morella, Chairman, House Subcommittee on D.C. Government Reform (1 copy)
Mr. Russell Smith, Staff Director, House Subcommittee on D.C. Government Reform (1 copy)
Mr. Mason Alinger, Professional Staff Member, Senate Subcommittee on D.C. Government Oversight (1 copy)
The Honorable Richard Durbin, Chairman, Senate Subcommittee on D.C. Government Oversight (1 copy)
Ms. Marianne Upton, Staff Director, Senate Subcommittee on D.C. Government Oversight (1 copy)
The Honorable Mary Landrieu, Chairman, Senate Subcommittee on D.C. Appropriations (1 copy)
Ms. Kate Eltrich, Staff Director, Senate Subcommittee on D.C. Appropriations (1 copy)
Mr. Stan Skocki, Legislative Assistant, Senate Subcommittee on D.C. Appropriations (1 copy)
Mr. Charles Kieffer, Clerk, Senate Subcommittee on D.C. Appropriations (1 copy)



2001 M Street, N.W.
Washington, DC 20036

To the Mayor and Council of the Government of the District of Columbia
Inspector General of the Government of the District of Columbia

We have audited the general purpose financial statements of the Government of the District of Columbia (the District), as of and for the year ended September 30, 2001, and have issued our report thereon dated January 22, 2002. In planning and performing our audit of the general purpose financial statements of the District, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the general purpose financial statements. An audit does not include examining the effectiveness of internal control and does not provide assurance on internal control. We have not considered internal control since the date of our report.

During our audit we noted certain matters involving internal control and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies and are summarized in the appendix to this letter.

Our audit procedures are designed primarily to enable us to form an opinion on the general purpose financial statements, and therefore may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of the District's organization gained during our work to make comments and suggestions that we hope will be useful to you. We would be pleased to discuss these comments and recommendations with you at any time.

This report is intended solely for the information and use of the Mayor and Council of the District of Columbia, the Inspector General of the District of Columbia, management and others within the District and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

KPMG LLP

March 31, 2002



KPMG LLP, KPMG LLP, a U.S. limited liability partnership, is
a member of KPMG International, a Swiss association.

EXECUTIVE SUMMARY

With the issuance of the September 30, 2001 Comprehensive Annual Financial Report (CAFR), the CAFR development and audit process is beginning to become a routine event. The financial reporting process has improved markedly during the Control Period. However, we believe it is critical for the District to continue to demonstrate to its stakeholders its commitment to further improvement in its financial management infrastructure. The comments in our management letter can provide District management with some ideas to help sustain the momentum generated over the last two years.

Address Material Weaknesses and Reportable Conditions

The first step in continuing to improve the financial management infrastructure is to address the material weaknesses and other reportable conditions highlighted in our Report on Compliance and on Internal Control over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards (Yellow Book Report). We have repeated those reportable conditions and our recommendations in Appendix A.

Material weaknesses in internal control discussed in that report indicate areas where the District's financial statements are vulnerable to material misstatements that may occur and not be detected within a timely period by District employees in the normal course of performing their assigned duties.. Immediate action should be taken by the Office of the Chief Financial Officer (OCFO) to address material weaknesses in accounting and financial reporting related to the District of Columbia Public Schools (DCPS), the University of the District of Columbia, and in the District medicaid program, so that the overall financial foundation of the District is strengthened.

Other reportable conditions relate to significant deficiencies in the design or operation of internal control over financial reporting that could adversely affect the District's ability to record, process, summarize and report financial data consistent with the assertions of management. These reportable conditions, while not as serious as material weaknesses, also warrant priority attention from District management. Matters currently classified as nonmaterial reportable conditions are as follows:

- Reconciliation of bank accounts and cash management
- Payroll process management
- Accounting for non-routine transactions
- Monitoring of expenditures against open procurements
- Reporting of budgetary revisions
- Disability compensation claims management

Our management letter comments, presented in Appendix B, highlight other internal control and financial management observations made during our audit, and what actions we believe the District should take to ensure its financial management infrastructure continues to improve. Many of our observations represent “best practices” in internal control and financial management against which we believe the District should be measuring itself. We also include observations about the impact of new accounting and financial reporting standards that the District must implement over the next two fiscal years. A separate management letter has been issued for the District of Columbia Lottery and Charitable Games Control Board, the University of the District of Columbia and the District of Columbia Public Schools. A summary of observations included in Appendix B follows:

Internal Control Observations

- *Improve document retention standards* – We observed numerous instances where the District’s documentation standards and related operating procedures are not being properly followed. For instance, employee timesheets are not always maintained in a manner to facilitate follow-up, should questions arise; data supporting employee withholdings are not adequately maintained in the official personnel folders; and participant eligibility files in the medicaid and food stamps program did not contain certain required information. Maintenance of information in these files is critical to demonstrating compliance with federal regulations, especially allowability of costs for federal grant programs.
- *Improve business continuity planning* – We observed that each District agency is currently responsible for developing its own individual business continuity plan. Improvements in this area are required at all levels; from District-wide to agency level and finally at the data center level. These plans should be coordinated so that a unified response can be developed, tested and implemented.

Financial Management Observations

- *Improve Department of Housing and Community Development (DHCD) financial management* – DHCD provides over \$40 million annually to community organizations to improve the housing stock available to District residents and to provide monies to local business to improve the local business economy. Many of the key financial functions, such as loan disbursements and collections, are provided by third parties. However, there is little oversight of these third parties, and activity processed by these service providers is not always reconciled to the District’s financial accounting system (SOAR) timely.
- *Improve Child and Family Services Administration (CFSA) financial management* – CFSA was returned to the District from receivership during fiscal year 2001. CFSA has been working diligently to incorporate its financial operations into those of the District; however, there are few documented policies and procedures at CFSA to assist in this integration. The lack of these policies and procedures led to a failure to submit required closing packages completely and timely.

- *Improve Grants Management Oversight* – The District receives over \$1 billion each year in federal awards, widely distributed across various District agencies. Each agency is primarily responsible for its own grants management; however, the Office of Research and Analysis (ORA) also monitors at a very high level all non-entitlement grants activity. We observed that while ORA assures that federal funds are drawn down timely based on what is recorded in SOAR, there is little oversight to ensure that expenditures are entered into SOAR timely so that federal funds can be drawn down. We observed significant adjustments to reimburseable revenues across several departments after year-end for which federal funds could have been drawn down had those expenditures been input into SOAR timely.

New Accounting Standards

While we have not specifically addressed in Appendix B to this letter the implementation of GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, we believe that implementation of this statement presents a significant challenge to the District in fiscal year 2002. GASB 34 is perhaps the most far reaching accounting standard ever issued by GASB. This statement creates two new, government-wide statements that present the net assets and activities of the District on a full-accrual basis. These statements supplement the fund financial statements that have previously been presented. Additionally, Statement 34 requires presentation of a management's discussion and analysis (MD&A), which is a narrative description of the financial operations of the District. MD&A is very similar to the transmittal letter currently presented in the CAFR.

OCFO has procured assistance from a consultant to implement this Statement. We encourage the District to create a "GASB 34 Steering Committee", to work in conjunction with the CAFR Oversight Committee, to monitor the progress towards successful GASB 34 implementation. Integral to this success is active participation by senior management of the District, including the Council. We would be pleased to present an overview of the Statement 34 requirements to Council upon its request.

Management's Responses

We provided a draft copy of Appendix A and Appendix B to District management for response. A condensed version of responses received has been included following each of our observations and recommendations. The full text of management's responses is available from the District's Office of the Chief Financial Officer. We have carefully considered those responses where management indicates it disagrees with either our observations or our recommendations. We continue to believe our comments are valid and that implementation of our recommendations will result in stronger internal controls or operational and financial management improvements.

The status of prior years' management comments are included in Appendix C. An analysis of the number of instances of material noncompliance, material weaknesses, and reportable conditions identified during fiscal years 2001, 2000, and 1997, the last three fiscal years audited by KPMG, is included in Appendix D. An analysis of the number of management letter comments issued, by process, during fiscal years 2001, 2000, and 1997 is included in Appendix E.

Material Weakness - District of Columbia Public Schools Accounting and Financial Reporting

The District of Columbia Public Schools (DCPS) expends over \$700 million annually in operating and capital expenditures. These expenditures are reported as a component of the District's public education function in the District's general fund and capital projects fund, respectively. During fiscal year 2001, we observed the following areas of weakness within the DCPS accounting and financial reporting processes:

- **Monitoring of expenditures** – The detailed break out of original budget approved by Council was not loaded into the accounting system by DCPS personnel timely to allow for appropriate monitoring of expenditures by DCPS management. Further, budget modifications were not loaded into the system timely and there were numerous instances of expenditures being incurred by program offices that were not submitted to the budget and finance offices for timely processing. During the fiscal year 2001 closing process, approximately \$7 million in amounts owed to vendors for goods and services received during 2001 and prior years, but not previously identified for timely payment, were required to be accrued for financial reporting purposes.
- **Accounting for medicaid expenditures** – DCPS incurs medicaid reimbursable expenditures primarily related to services provided to special education students at private schools by third party contractors. However, because the private schools and other vendors do not always provide sufficient or timely encounter data to the DCPS medicaid program office, many of these costs are considered ineligible for reimbursement by the US Department of Health and Human Services. At September 30, 2001, a significant adjustment was required to reduce previously recorded medicaid revenues and receivables that were no longer considered collectible. Further, the medicaid program office appears to have no established process to follow up with vendors to obtain necessary encounter data to improve DCPS's ability to receive medicaid reimbursement for special education student services provided. Finally, there is no process in place to provide for timely communication between the medicaid program office and the DCPS office of financial operations.
- **Capital projects expenditures** – The DCPS capital projects expenditures are processed by purchase orders issued directly by the DCPS CFO's office rather than through the DCPS's procurement office. The procedures for issuing purchase orders are not documented and subsequent invoice processing against the purchase orders do not include the controls for approval that are required for other DCPS procurements. For fiscal year 2001, the majority of the expenditures for capital improvements were provided through service agreements with the Army Corps of Engineers. These agreements define the scope of work to be performed and the source of funding. Various purchase orders are issued against the service agreements; however, there is no process to reconcile goods and services obtained to the provisions of the service agreements. Further, the account coding of expenditures between capital and local funding is not adequately monitored.

- Payroll processing – DCPS failed to appropriately pay approximately 1,700 DCPS employees compensation for pay increases that were due, but not timely processed by the human resources and payroll departments, amounting to approximately \$2.4 million. We also observed numerous instances of employee payroll time sheets, which often provide DCPS's primary basis for obtaining federal reimbursement of eligible payroll costs, that could not be located. Finally, we observed that the payroll reports generated by the CAPPS system are not reconciled timely to the DCPS payroll posted to the general ledger.

Each of these items contributes to the risk that the financial reports relied upon by DCPS management may not be accurate. Accurate and timely management information is essential to DCPS management's ability to identify and respond to significant financial changes (e.g., revenues shortfalls and expenditures in excess of budget). To improve DCPS internal control over financial accounting and reporting, we recommend the following:

- Ensure that DCPS personnel load the annual operating and capital budgets into the accounting system timely and in sufficient detail to allow management to monitor expenditures versus budget more closely. Such information, along with an analysis of significant variances, should be provided to the DCPS School Board on a monthly basis.
- Require medicaid service providers to provide relevant encounter data to permit DCPS to bill the Medical Assistance Administration (MAA) timely and in sufficient detail to ensure claims for reimbursements are not denied. We understand that requiring such information from the service providers may not be possible under existing contracts. Because the special education program, and the required payments to service providers, are under various court orders, it may be necessary to petition the Court to require service providers to provide such information in a timely manner.
- Monitor contractors hired to administer DCPS capital projects programs more closely. Further, each month DCPS management should review capital expenditures accounts to ensure that there are no significant budget variances and to identify and correct potential improper coding of expenditures between local and capital.
- Monitor the timing of pay increases more closely to ensure that all pay rate changes are processed timely. DCPS management should reemphasize to its timekeepers that adequate maintenance of payroll time sheets is critical to maximizing federal reimbursement under federal grant programs.

We further believe that DCPS has a unique opportunity to evaluate the adequacy of its existing financial accounting and reporting processes due to the anticipated implementation of the PeopleSoft system. We recommend that DCPS conduct a comprehensive review of its payroll, procurement, budget, capital expenditures and medicaid program accounting and financial reporting processes in conjunction with this system implementation.

Management's Response

See separate DCPS management letter for management's response.

Material Weakness - University of the District of Columbia Accounting and Financial Reporting

The University of the District of Columbia (UDC) expends approximately \$80 million each year. UDC maintains separate bank accounts in addition to participating in the District pooled cash management program. It also maintains several detail subsidiary ledgers to account for its student tuition and grants receivable. UDC uses the District's System of Accounting and Reporting (SOAR) as its general ledger and is required to post and reconcile its separate bank accounts and receivable subledger activity to the amounts recorded in the general ledger. Based on the information derived from these ledgers, the University produces stand-alone financial statements, and the University's financial position is summarized in the District-wide CAFR.

During fiscal year 2001, UDC experienced significant turnover in its financial management personnel. With the assistance of a task force deployed to UDC by the District's CFO and subsequently the leadership of a new financial management team, including a new Chief Financial Officer, the University has made progress towards addressing several key issues affecting financial management that were noted in prior years. Specifically, during the last eight months of the fiscal year, the University has made improvements in the effectiveness of its financial management, some of which include the following:

- cash reconciliations completed on a monthly basis;
- reclassification of payroll default balances performed on a timely basis;
- quarterly transfers from the postsecondary account to the District's pooled cash maintained by the DC Treasurer;
- quarterly billings performed for intradistrict activities; and
- financial review process (FRP) reports submitted to Office of Budget and Planning (OBP) on a monthly basis.

In spite of the task force's efforts, the financial position and results of operations of UDC were not readily determinable during a substantial part of the year, and UDC management again required outside contractor assistance in order to close its books for fiscal year 2001 and complete the closing packages required by OFOS on a timely basis.

We recommend that the University undertake a comprehensive review of its financial management systems, addressing such issues as:

- Internal staffing levels, roles and responsibilities and relevant training issues;
- Communication between financial and operational personnel at UDC and between UDC and District financial management to ensure appropriate guidance in the performance of duties is available, and all relevant information is considered in making financial decisions and preparing financial reports;
- Extent and nature of involvement of external consultants throughout the year and in the year-end closing process; and

- Effectiveness of training efforts on existing IT systems, including SOAR and SIS Plus, and the extent to which the implementation of these systems meet the needs of University senior management.

Management's Response

UDC's management does not concur with the recommendation regarding staffing levels, roles and responsibilities and relevant training issues as it believes that corrective actions for internal staffing levels and roles and relevant training issues has been developed and partially implemented. While we have been able to hire new managers in key areas and shift staff to positions that better meet their skills and the Division's needs, the most recurring impediment to making significant process in this area is the lack of the necessary funding to hire the staff that is needed.

UDC management partially concurs with the recommendation regarding improving communications between financial and operational personnel at UDC and between UDC and District financial management. The University has recognized the need to bridge the communication gaps in several areas within UDC's operations. As such, UDC has hired a Vice President for Management whose charge is to help improve the interrelationships between the various areas within the University to community and to the extent practical, with parties' external to the University community. One of the Finance Division's most critical goals is to improve our processes for providing customer service of the highest quality. This will require establishing methods for improved communications, timely feedback and response and reliable financial reporting. We are working on developing mechanisms for monthly internal financial reporting (with the generation of monthly financial statements, monthly budget to actual analyses and other similar reports.) The dissemination of such information on the periodic basis will provide the foundation for informed discussion of financial management issues.

UDC Management partially concurs with the recommendation regarding the extent and nature of involvement of external consultants throughout the year and in the year-end closing process. Being that UDC has not been able to hire the sufficient number of staff in the Finance Division, it was important to have individuals in place to "back fill" as needed. It would be more prudent, in the future; however, to invest the funds spent each year for year-end contractual services toward hiring and right sizing the Division with qualified, competent staff to further enhance the team currently in place.

UDC management concurs with the recommendation to evaluate the effectiveness of training efforts on existing IT systems, including SOAR and SIS Plus, and the extent to which the implementation of these systems meets the needs of University senior management. One significant factor is our need to obtain and implement a fully integrated system that links financial information, student information, procurement, human resources and faculty data. Funding is being pursued for such a system. In addition, the University is planning to hire a Chief Information Officer (CIO) to develop and implement an IT plan that is most feasible for UDC, meeting the needs of both management and the UDC community and to address the numerous recurring IT problems noted by the auditors.

Material Weakness - Accounting and Financial Reporting for the District Medicaid Program

Various District agencies, including the DCPS, Child and Family Services, the Department of Mental Health (DMH), Fire and Emergency Services, Mental Retardation and Developmental Disabilities Administration, and the former Public Benefit Corporation, provide medicaid services to eligible District residents. The costs incurred by these agencies are summarized in a cost report that is submitted to the MAA, part of the District's Department of Health, for approval before those claims are submitted to the federal government for reimbursement.

We observed that the agencies record a receivable and revenue in SOAR for the federal share of their medicaid claims incurred, and MAA records a payable and an expense to the agencies for the claims submitted. However, these amounts were not eliminated for financial reporting purposes during the year, but rather through an audit adjustment at year-end. We also observed that the agencies and MAA also budget medicaid revenues and expenditures in the same manner.

We also observed that, once the cost reports submitted by the agencies are audited, MAA has disallowed a significant portion of the medicaid costs submitted for reimbursement by these District agencies. Reasons for the disallowances are generally a failure to file medicaid claims timely as well as to provide sufficient support for the claims that are incurred. We further observed that disallowed costs are generally appealed by the agencies and revised cost reports are resubmitted with additional documentation after a significant period of time. The difference between costs submitted for reimbursement and the costs actually reimbursed result in the use of local, rather than federal, dollars to fund these expenditures.

Finally, we observed that agencies are not recording reserves for disallowed costs as a result of cost report audits. As a consequence, aggregate audit adjustments exceeding \$100 million were required to be posted as part of the year-end closing process.

To improve the accounting and financial reporting for the medicaid program, we recommend the following:

- Modify the financial reporting process to ensure that transactions between MAA and the agencies are properly eliminated to ensure that medicaid revenues and expenditures are not double counted for budgetary and financial reporting purposes.
- Require all agencies that prepare and submit medicaid cost reports to MAA to record reserves for disallowances included in their audited cost reports timely.
- Create a working group between MAA and the provider agencies to improve communication and better coordinate the submission of claims by agencies in a form that is acceptable to MAA. This will allow the District to reduce the time between the medicaid expenditures being incurred and the ultimate reimbursement from the federal government.

Management's Response

The Department of Health (DOH) concurs with the first recommendation. We are working with the Office of Budget and Planning to establish an intra-district arrangement between DOH and other agencies in the FY 2003 budget. This will ensure that federal Medicaid revenues and expenditures are properly eliminated for financial reporting purposes.

DOH does not concur with the second recommendation. MAA is the state agency and other district agencies are Medicaid providers. MAA is responsible for providing guidance to the agencies relative to allowable Medicaid costs and applicable cost principles. However MAA has no authority to require agencies to reduce cost submissions or create reserves.

DOH concurs with the third recommendation. In October 2001, the District formed the Medicaid Management Committee (MMC) whose mission is to coordinate Medicaid activities city-wide by developing and implementing objectives, policies, and strategies that meet federal requirements, and allow for maximum recovery of federal funds. Monthly MMC meetings are chaired by the Senior Deputy Director for MAA, and are attended by program and finance representatives from each agency.

Reportable Condition - Reconciliation of Bank Accounts and Cash Management

The District uses a pooled cash arrangement to manage cash collected by the Office of Tax and Revenue and other District agencies. As of September 30, 2001, there were approximately 50 pooled cash bank accounts. In order to ensure all bank accounts were properly reconciled and related adjustments were posted to the general ledger, the Office of Financial Operations and Systems (OFOS) established a cash management reconciliation unit (CRU). At various times throughout the year, the CRU was staffed by over 20 District employees and contractors whose sole responsibility was to reconcile pooled cash bank accounts. However, in spite of these efforts, reconciliations of the pooled cash accounts were not always completed timely. We did, however, observe improvement in the timeliness of reconciliations by CRU during the last half of the fiscal year.

Although reconciling items were identified, they were not always resolved timely, and were often carried forward on reconciliations for several months. We observed the following reasons for significant reconciling items:

- Once reconciling items are matched, there is confusion among CRU and the District agencies as to whose responsibility it is for recording the journal entry to resolve the reconciling item.
- Deposits made by agencies into pooled cash accounts through the Office of Finance and Treasury (OFT) are recorded by OFT in such a manner that does not facilitate matching of transactions by CRU. For instance, a single bank deposit may be summarized into several SOAR journal entries. Matching by CRU occurs at the individual bank deposit to SOAR journal entry level.
- OFT obtains a daily listing of all deposits made into District pooled cash accounts from the various banks. OFT records journal entries for those deposits that it is responsible for recording. However, if a deposit was made on behalf of an agency and the agency is unaware of it, OFT does not routinely attempt to identify where this deposit should be recorded in SOAR. Therefore, amounts have been recorded in the bank statement but no entry has been recorded in SOAR.

The reconciliation of bank accounts to amounts recorded in the general ledger is an essential control to ensure cash receipts and disbursements are completely and accurately processed, and that cash balances are safeguarded from potential misappropriation. We recommend that CRU provide detailed guidance to OFT as to the journal entry format that is needed by CRU to facilitate matching of bank transactions. We further recommend that OFT establish a process to communicate with all agency CFOs to determine proper ownership of deposits made to bank accounts for which adequate information is not available. Once identified, the deposit should be properly recorded at both the agency and OFT level. Finally, we recommend that the CRU continue to devote substantial attention to reconciling all pooled cash accounts within 45 days of month end.

Numerous District agencies also maintain bank accounts that are not part of the pooled cash arrangement. These agencies are responsible for reconciling these agency controlled bank accounts to the general ledger timely and resolving all reconciling items for these accounts. We obtained a listing of all agency controlled bank accounts from OFT, noting that there are over 650 bank accounts maintained at various District of Columbia financial institutions under the District's taxpayer identification number. Although the number of such accounts has been significantly reduced since the prior year, some of these bank accounts continue not to be recorded in the general ledger. During fiscal year 2001, OFT and OFOS worked with the agencies controlling these accounts to verify that all agency controlled bank accounts were reconciled and recorded in the general ledger. However, we continue to observe that District agencies establish bank accounts without notifying OFT as required by District policy. We believe the number of bank accounts maintained by the District (both pooled cash and agency controlled) has contributed to untimely bank reconciliations. We recommend that OFT and OFOS continue to analyze the number of bank accounts necessary to facilitate cash management. A further reduction of the number of bank accounts will help to improve the timeliness of bank reconciliations, enhance monitoring of collateral requirements, and provide improved opportunities for investment earnings on the cash balances. Additionally, we recommend that OFT again notify all agencies of the requirement to report all bank accounts separately maintained under Agency control.

Management's Response

We concur with the recommendation that the CRU provide detailed guidance to OFT as to the journal entry format that is needed by CRU to facilitate matching of bank transactions. Under the current arrangement, agencies submit their daily deposit to the main cashiering office for processing. These items are incorporated in the consolidated deposit in the District's Custodial account for pooled cash. OFT and OFOS have met to discuss OFT instituting a procedure to prepare separate deposits for each agency depositing through the main cashiering office. This will facilitate the matching of bank transactions by OFOS.

We concur with the recommendation that OFT establish a process to communicate with all agency CFOs to determine proper ownership of deposits made to bank accounts for which adequate information is not available. Once identified, the deposit should be properly recorded at both the agency and OFT level. OFT will develop a mechanism to communicate to agency CFOs deposits not known to OFT, which need to be recorded. CFO's in the agency will be responsible to insure that revenue documents are properly transmitted to OFT.

We concur with the recommendations that OFT and OFOS continue to analyze the number of bank accounts necessary to facilitate cash management. A further reduction of the number of bank accounts will help improve the timeliness of bank reconciliations, enhance monitoring of collateral requirements, and provide improved opportunities for investment earnings on the cash balances. We concur with the recommendation that OFT again notify all agencies of the requirements to report all bank accounts separately maintained under Agency control. OFT will continue its effort to close and consolidate bank account activity. As noted, during the prior year, OFT closed in excess of 600 bank accounts and OFT's objective is to close an additional 150 to 200 accounts.

Reportable Condition - Payroll Process Management

Over 40% of the District's annual operating expenditures are for employee compensation and benefits. The maintenance of employee personnel information such as personnel action forms and withholding authorizations is a critical component of internal control over the payroll process. Time sheets documenting (1) the hours worked by employees, (2) related grants or other projects charged and (3) review and approval must also be maintained. We observed the following:

- Twenty-nine of 170 employee timesheets, primarily at the Fire Department, the Department of Human Services, and the Department of Public Works, could not be located or lacked evidence of appropriate management authorization, review and approval of hours worked. We were able to identify other sources of information, such as daily work logs maintained at the fire houses and at the various District agencies, to substantiate the hours worked.
- Inadequate maintenance of personnel files as evidenced by (1) a number of missing files, (2) files that contained information for more than one employee, (3) incomplete files where appropriate authorization forms were missing, and (4) inadequate physical safeguards over files at storage locations.
- Terminated employees were not always removed from the payroll systems timely.
- Changes to the CAPPS payroll database were not always made timely, and because of CAPPS system limitations, certain employees who were due annual step increases were not awarded those increases when due, requiring retroactive payroll adjustments. These pay adjustments amounted to approximately \$12.8 million during fiscal year 2001, of which approximately \$4 million was payable at September 30, 2001.

To improve internal control over the payroll process we recommend that the District:

- Train agency timekeepers on better methods of ensuring proper documentation is on file for all timesheets, annual leave, and sick leave forms.
- Establish a methodology for employee file maintenance and related physical safeguards at each file room and assign responsibility for these matters to a single employee at each location.
- Develop a standard checklist to ensure that all personnel files contain appropriate supporting documentation. Consider a periodic unannounced review of existing files to determine the completeness and accuracy of file data.
- Reinforce established procedures for employee terminations to ensure that they are processed timely.

Management's Response

Management partially concurs with the finding that leave slips and timesheets were not available for the audit. Although the District Personnel Management requires that all employees certify the use of leave by either initialing the time and attendance or by signing the SF-71 (application of leave), agencies are not required and do not maintain the SF-71 centrally. It is implied that if the

employee does not initial the time and attendance sheet, the SF-71 has been completed and is being maintained by timekeeper at the respective locations. As a result of this finding, agencies are in the process of issuing a memorandum stressing the importance of maintaining supporting documentation for all leave used and all time worked.

Management concurs with the finding that certain files are not properly maintained. The Office of Personnel (DCOP) has not only established a methodology for employee file maintenance and related physical safeguards, but it has also initiated a major overhaul of filing systems for all Official Personnel Folders (OPF's) under its control. Additionally, DCOP is taking steps to hire a full-time Records Coordinator who will be responsible for overseeing records management for the agency and the anticipated hire date is May 2002. The Record Coordinator will be responsible for continuing to develop processes and internal procedures for the management of all OPF's under DCOP control, and further refining physical controls on OPF's.

DCOP concurs that step increases are not always made timely for the CAPPS based agencies that we service. We cannot concur with the cost estimate since we are not familiar with how it was derived. We note that in the CAPPS Payroll System, client agencies must submit a written request in order to get step increases processed. In the UPPS System, the step increases do not require paper request or manual actions, and are programmed into the system as automatic activities. Client agencies that are on CAPPS but are not vigilant about tracking their employees' pay entitlements can easily fall behind in the submittal of step increase requests. Without receipt of such requests, DCOP and OPRS are not authorized to make the step increases. In FY 2002, all agencies except DCPS will leave the CAPPS system and return to the UPPS system.

A standard checklist for ensuring that all personnel files contain appropriate supporting documentation already exists. To reinforce the checklist, management will examine existing internal procedures, and develop new/revise ones, to ensure that the checklist's provisions are consistently applied to all OPF's., and will randomly sample OPF's to ensure that all required documents are present;

Management will reinforce established procedures by issuing new/revised guidelines and providing training to HR Advisors and CFO's in agencies that we service. In addition, client agencies must be held accountable for submitting termination paperwork on time, since their HR Advisors and CFOs are in the best position to know if attrition has occurred.

Reportable Condition - Accounting for Non-Routine Transactions

Each year, the District enters into various transactions that do not occur on a routine basis in the normal course of business. Often, these transactions are material to the general purpose financial statements, particularly the general fund. During fiscal year 2001, such non-routine transactions included the sale of the DOES building to the Freedom Forum, the issuance of tax increment financing notes, the cessation of the Public Benefit Corporation (PBC) and subsequent outsourcing of services previously provided by PBC to the DC Healthcare Alliance, the establishment of the Tobacco Asset Securitization Corporation (TASC), and the subsequent issuance of debt by the TASC, and the acceptance of the Casey Foundation gift of a mayoral mansion.

Although these transactions occurred throughout fiscal year 2001, the journal entries to record many of these transactions did not occur until after year-end. For instance, when the cash proceeds for the sale of the DOES building were deposited into the District's escrow account, no corresponding accounting entries to record the transaction were recorded in the general ledger until after year-end. We recommend that OFOS establish procedures to obtain timely information about these transactions, research the appropriate accounting and financial reporting treatment, and prepare journal entries to record non-routine accounting transactions timely. The source of information for such entries should be review of Council minutes, bank reconciliations, minutes of CFO Council meetings, and other communications between District financial and operational management, whether written or oral.

Management's Response

We concur with the recommendation that the Office of Financial Operations and Systems (OFOS) establish procedures to obtain timely information about these transactions, research the appropriate accounting and financial reporting treatment, and prepare journal entries to record non-routine accounting transactions timely. OFOS is currently in process of reviewing documents from the Executive and Legislative branches of the Government of the District of Columbia, such as minutes of meeting, legislative actions, mayoral directives, District Register and other official documents to ascertain the effect of actions/decision on the accounting records of the District as appropriate.

Reportable Condition - Monitoring of Expenditures Against Open Procurements

Agency finance personnel must approve each contract award to indicate that there is available budget for the goods or services being procured. Based upon this approval, the procurement staff finalizes the contract documents. It is the responsibility of the agency finance personnel to properly, and timely, encumber the funds. However, we observed that such encumbrances are not always recorded timely

Encumbrance monitoring is further complicated by the fact that there is no linkage between the contract files and SOAR. SOAR, through ADPICS, is a purchase order number driven system. In order to process vendor invoices, ADPICS assigns a purchase order number; however, this number bears no relationship to the contract number. Because there is not a one-for-one relationship between the actual contract and the purchase order recognized by SOAR, and because encumbrance information is not readily available, it is possible for payments against purchase orders to exceed the contract value.

While the finance officer should continue to authorize the available funds, we recommend that policies be established to assign the contracting officer the responsibility for recording the encumbrance prior to finalizing the contract. This would ensure that the encumbered funds are in agreement with the final contract value and provide a stronger segregation of duties since the contracting officer has no role in approving or paying invoices. Further, we recommend the District develop a monitoring and reporting mechanism that will relate the contracts to the purchase orders and help ensure that payments in excess of contract values are not made.

Management's Response

The Office of Contracting and Procurement concurs with the first paragraph insofar as it states that encumbrance of funds is a function of agency finance personnel and that procurement staff finalize contractual documents after the finance personnel encumber funds. Any failure to encumber timely is not within the control of OCP.

As to the second paragraph, OCP concurs that there is no linkage between the contract files and SOAR. This was and remains one to the weaknesses of SOAR. OCP is concerned about the statement that "it is possible for payment against purchase orders to exceed the contract values." Since each contract has an encumbrance that reflect the exact dollar amount allocated to the contract, and invoices against a contract can only be paid if they are linked to a specific encumbrance number and are within the dollar limitation of the encumbrance, it is unclear how payment beyond the contract value is occurring. It is also beyond the ability of OCP to manage the problem, since OCP does not control the encumbrance of payment process.

OCP does not concur with the recommendation that policies be established to assign the contracting officer the responsibility for recording the encumbrance prior to the establishment of the contract as it believes that this could potentially present segregation of duties issues. Further, OCP does not believe that they are adequately staffed to provide such a function.

Reportable Condition - Reporting of Budgetary Revisions

The District of Columbia Appropriations Act (Appropriations Act) serves as the original appropriated annual budget. The Appropriations Act authorizes expenditures at the functional level. Generally, all revisions that alter total appropriations of an individual function must be approved by an act of Congress. The District then allocates the revised appropriations at the functional level to various agencies within the function. The District may reallocate budget amounts among agencies within a functional level in accordance with District policies contained in the Reprogramming Policy Act. The Office of Budget and Planning (OBP) is responsible for tracking all local budget authorized reprogrammings, while the Office of Research and Analysis is responsible for all non-local budget authorized reprogrammings.

We observed that approved local budget reprogrammings are posted to a manual tracking sheet maintained by OBP personnel. OBP personnel then use these manual tracking sheets to compare the revised budget amounts to SOAR balances to ensure that agencies have not overexpended their revised appropriated budgets. Most reprogrammings are not loaded into SOAR to facilitate agency review of total expenditures versus the revised appropriated budget, and as a result agencies must contact OBP to obtain a current status of reprogramming requests and the total revised appropriated budget. As designed, this control serves only to detect, not to prevent, possible budget overexpenditures.

We recommend that OBP assure all budgetary reprogrammings are recorded in SOAR upon approval and notify the requesting agency of such approval. This will enhance the agencies' ability to monitor the status of their reprogramming request and will provide them with accurate budgetary information against which to monitor expenditures.

Management's Response

Management partially concurs with the findings. The OBP manual tracking sheet serves two purposes: (a) to check the budget authority posted to SOAR and (b) to present budget modifications including reprogrammings for the CAFR. In FY 2001, OBP budget analysts worked with agencies to enter batches and overrode the batches in SOAR; errors have occurred in the amounts of budget authority posted to SOAR. This was found through the periodic reconciliation of off-line tracking sheets to the budget authority in SOAR. The reconciliation process also revealed errors in the off-line tracking sheets. To prevent such errors, modifying the budget authority and reprogramming postings in SOAR will be done centrally by the Data Management Unit in OBP instead of by various budget analysts in FY 2002. OBP is also developing a system so that reconciliations will be performed on a monthly rather than a periodic basis throughout the year.

SOAR does not provide a budget modification report that can be used for CAFR purposes. The District will look into developing an Executive Information System (EIS) report that can extract the appropriation information from SOAR. Such an EIS report would also make it less burdensome for the agency to track reprogrammings and other budget modifications throughout the fiscal year.

Reportable Condition - Disability Compensation Claims Management

The Department of Employment Services (DOES) was responsible for administering the District's disability compensation program through September 30, 2001. When a District employee becomes disabled due to an on-the-job illness or injury, the responsibility for that employee's compensation is transferred from the agency for which they work to the Office of Benefits Payments of DOES. The Office of Benefits Payments paid over \$32 million in disability compensation benefits during fiscal year 2001 and has recorded an actuarially computed liability of over \$200 million for benefits that it expects to pay in the future for workers currently eligible to collect disability compensation. On June 29, 2001, Council enacted legislation that, effective October 1, 2001, removed the responsibility for disability compensation claims management from DOES and assigned it to the Office of Personnel.

We examined a sample of claim files for participants receiving benefits under the program to ensure data provided to the actuary was complete and accurate. In our sample of 61 recipients (out of 897 recipients), we identified 10 recipients whose claims data contained errors. Additionally, we identified 7 beneficiaries who were incorrectly classified in the temporary total disability category instead of the scheduled award category in fiscal year 2001. Although these errors were ultimately corrected upon auditor request when reconciled to data maintained by the third party administrators after year-end, we recommend that benefit data be reconciled to the data maintained by third party administrators on a more timely basis so that accurate disability compensation records are maintained and the liability can be accurately determined at any point in time.

We observed that employees returning to work from disability are not required to notify DOES of this event. The agency to which the employee has returned is required to process the payroll change information. However, we continued to observe that this paperwork is not always prepared by the agency and provided to DOES timely. Therefore, a formerly disabled employee could receive both a disability compensation check and a regular payroll check until DOES is notified that the employee has returned to work. We identified 2 beneficiaries who were being paid on a temporary total disability award basis and continued to collect regular payroll checks, one beneficiary who was determined to be ineligible by court order and continued to receive disability compensation, and another beneficiary who did not return to work after his release from medical treatment, but who continued to receive disability compensation. These and similar situations resulted in overpayments of approximately \$930,000 to formerly eligible recipients of disability compensation in fiscal year 2001.

The District is attempting to collect approximately \$2.7 million in cumulative overpayments as of September 30, 2001. We observed that the Office of Personnel established a procedure, effective October 1, 2001, to identify beneficiaries receiving a disability compensation payment as well as a regular payroll payment, for subsequent determination of the propriety of receiving both types of payments and for eliminating duplicate payments. We recommend that OFOS monitor whether continuing follow up is being made to collect amounts owed to the District due to overpayments. We also recommend that OFOS determine whether the Office of Personnel is following their newly established procedure.

Management's Response

DOES management does not concur with the findings or the recommendations presented. However, the responsibility for managing the disability compensation program has been transferred to the District's Office of Personnel effective October 1, 2001.

The Office of the Chief Financial Officer concurs with the recommendation for monitoring whether continuing follow up is being made to collect amounts owed to the District due to overpayments. Also, OCFO concurs with the recommendation that OCFO determine whether the Office of Personnel is following its newly established procedures. The OCFO's Internal Audit and Internal Security (IAIS) has incorporated these issues in its annual audit plan to be addressed accordingly; and is continuing to ensure that established policies and procedures are adhered to by the agencies as part of its regular internal audit work as outlined in the annual audit plan. IAIS also will ensure that external auditor's recommendations are properly addressed or effective planned actions are in place.